DOW THEORY LETTERS INC.

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36 Letters per Year—$60.00 Annually

Registered with the Securities Exchange Commission

May 23, 1969 Letter 428

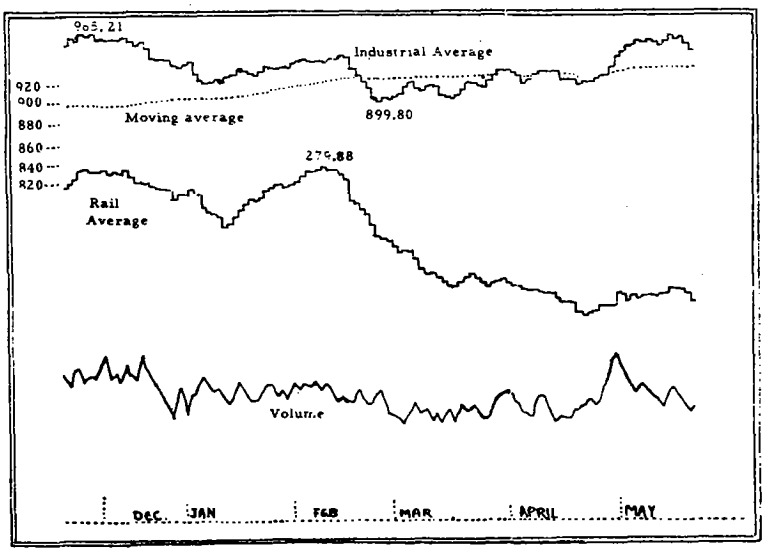
THE MARKET: On May 15 the U.S. announced a $1.75 billion balance-of-payments deficit, the greatest quarterly deficit since 1950. Most of the bears expected a deficit in the neighborhood of $1 billion, and the huge first quarter deficit gives evidence of the serious position which this nation has gotten itself into.

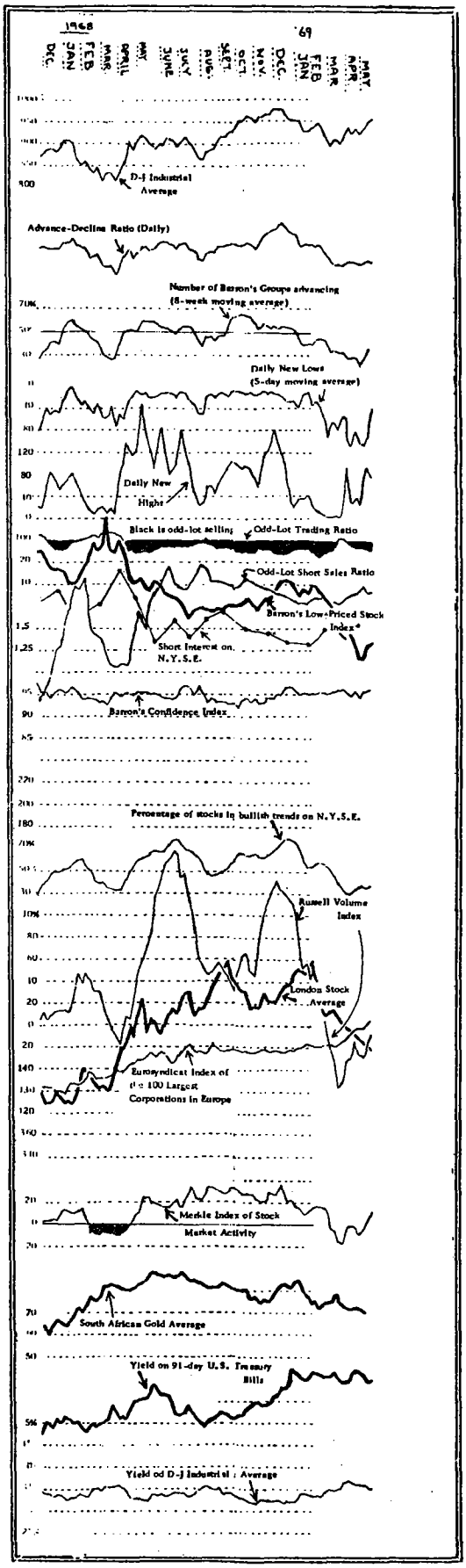
At the same time, with the German mark holding at its fixed level (without being re-valued), skepticism continues regarding the ability of the franc and the pound to withstand collapse. Both of these weak currencies are hovering at their lows with whopping April balance-of-payments deficits being reported by both Britain and France.

Money rate pressure in the U.S. and throughout the world remains relentless, and the net borrowed position of U.S. member banks continues at the $1 billion level, the greatest borrowed position in history.

Aside from the inflation and monetary scene, the other chief source of agony is the Vietnam war. Here too, the optimistic side is confined to hopes while the pessimistic side has to do with reality. Personally (and I have said this over and over again), I do not feel that either the Administration or the American people see the war in the stark light of reality. Hanoi has been fighting for decades, and the existence of a U.S. army in Vietnam is but one more (but a much more serious) chapter in North Vietnam's age-old battle to take control.

Talk of a U.S. scale-down or a series of troop withdrawals can only appear in Hanoi's eyes, as part of an ultimate victory for Hanoi. Why would Hanoi enter a compromise agreement now, when she sees victory closer today than say two years or three years ago? I could easily be miscalculating, but I do not see Hanoi grasping at a U.S. compromise offer. I see Hanoi interested only in victory (taking control of all Vietnam), and thus I note nothing in President Nixon's May 14 speech which will hasten peace or end the war.





 The stock market, it appears to me, is living on hopes and dreams. The primary bear market forces have been held back by a mixture of inflation, booming business, monetary delusions, plus misconceptions regarding the Vietnam war. Now the monetary picture is assuming really serious proportions (see quotes in the last Letter from Bolton Tremblay Bank Credit Analyst), and I believe that the rise since the 1966 lows is existing on borrowed time.

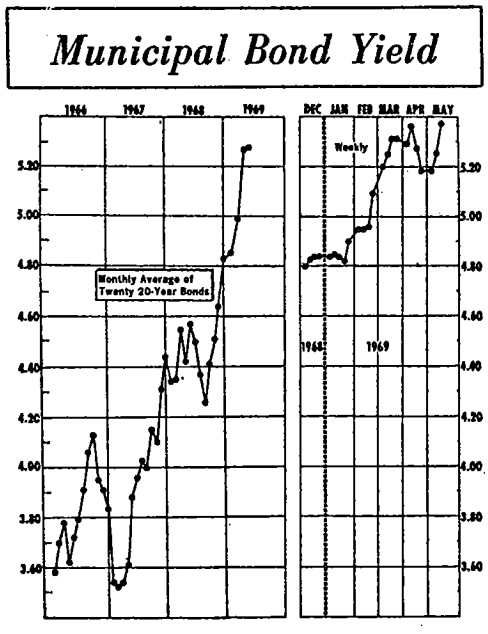
When a bull market ends, as it did in February, 1966, a bear market takes over. The peak of the bull market occurred in early 1966, and at that time the best that could be seen ahead was fully discounted. The market in February, 1966, was saying that things were going to get considerably worse before they get better. And this is the reason why inflation and the sum total of all the events since 1966 have been unable to take the two Averages to new highs (above the 1966 highs). The grim fact is that the great primary bull market which began in 1949 ended in February, 1966, and everything since then has been a holding action, a massive resistance to the bear forces which will sooner or later express themselves in a bear market of major and serious proportions.

Before 1969 is out, I would expect the teeth of the bear to show in earnest. It would not surprise me to see the 1966 Dow low of 744.32 smashed sometime during 1969 as the bear market enters its downward phase again.

Over the short term, the most recent rally which began in February seems to have run out of steam. The rally has all along been unsatisfactory, with strength being extremely selective in individual stocks, with the advance-decline ratio laggard and unable to better its March peak, and with the Rail Average notably unable to confirm Industrials. The five-day average of new highs was able to reach a figure of only 104 (May 6) on the rally, despite a new recovery high for the Dow, while the five-day average of new lows never dropped below 32 during all of 1969. Thus the new lows suggested continuous selling pressure, while the dull record of new highs indicated only selective buying power.

On May 19 the market suddenly reversed to the downside with Industrials closing off 8 points. The next day saw the decline continue with Industrials off another 9 points. This took the senior average to 949.26, its lowest since May 1. Little can be deduced from two days action on the Exchange, but this writer could not help but feel that the Dow was beginning to appreciate the seriousness of both the monetary situation and the Vietnam stalemate.

BONDS: In the last Letter I cautioned against the widely-held opinion (hope) that the bond markets had struck bottom. Such bottoms, it was noted, usually come amid periods of financial crisis, followed by credit liquidation. The financial crisis is close but not yet upon us, and the bond markets seem to know it.



Last week the Municipal Bond Average (see chart) hit a new high yield of 5.37%, highest in 40 years. The broad D-J 40-Bond Index was within a fraction of its 36 year low, and Government bonds were sinking across the board. The bellwether of the short-term money market, the Treasury 91-day bills pushed over the 6% yield level again.

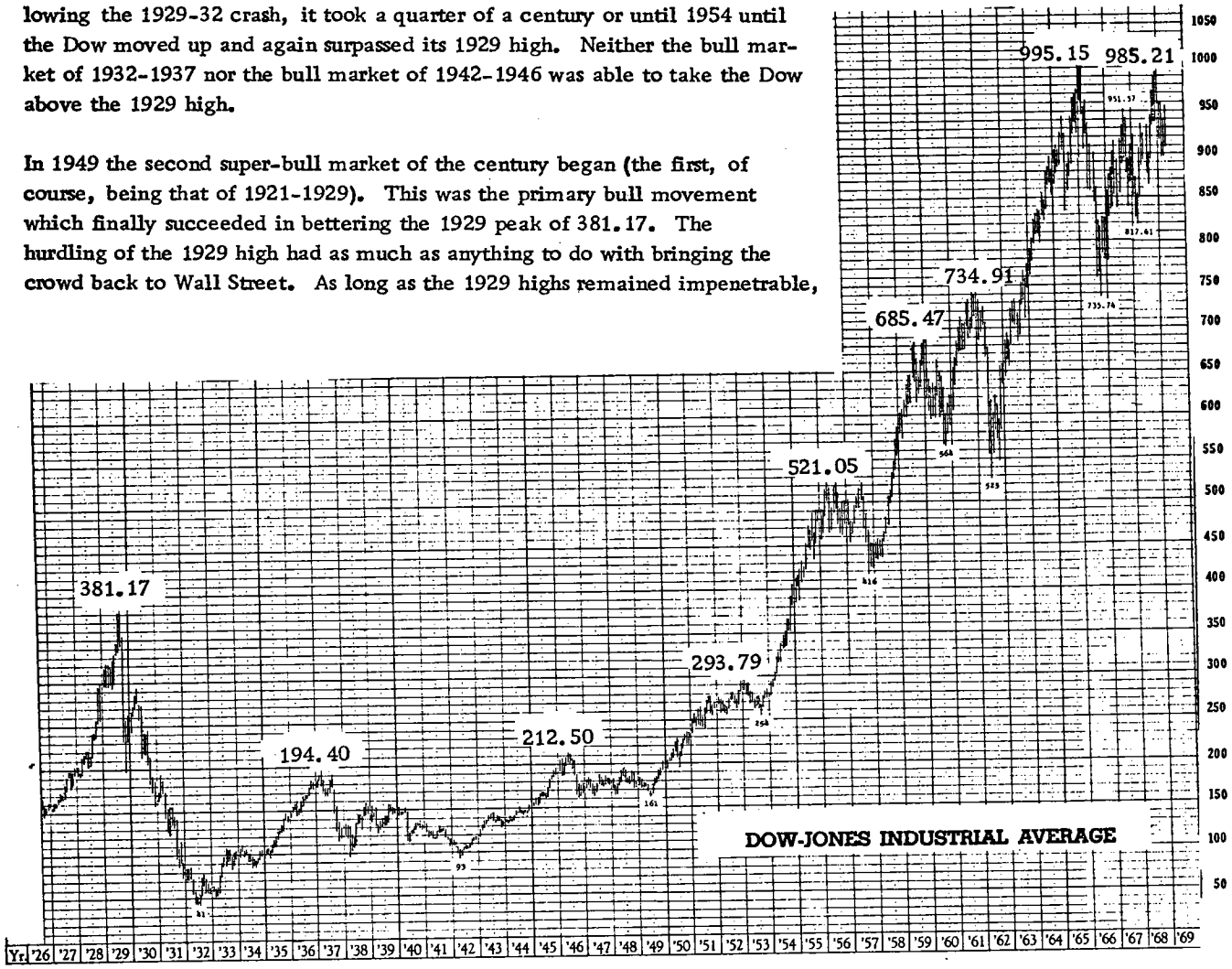
Last week Federal Funds, uncommitted reserves which the banks lend each other overnight, traded at an amazing 9% to 9.5%, a level reached only twice before (April 30 and May 9). More and more, banks have been relying on Federal Funds to compensate for the loss of deposits caused by the Fed's war on inflation. Because of the unrelenting pressure, talk is now of another boost in the current record 7.5% prime rate.

Here and there, hints of a potential economic collapse are beginning to appear. Car dealers are starting to offer discounts of up to $300 on new cars, as sales turn soft. Housing starts are off to below the 1.5 million a year level. Since the second quarter of 1968, gains in physical volume of U.S. goods produced has been progressively smaller. Disintermediation has been going full blast at the savings and loans institutions; April showed a loss of $650 million, more than twice the loss of April,1968. At mutual savings banks savings shrank by $200 million in April, compared with a $75 million reduction in April, 1968.

PERSPECTIVE: The accompanying, Page 3, chart (courtesy of M.C. Horsey, 37 Wall St., N.Y.C.) offers a long-term perspective on the D-J Industrial Average. The first thing which comes to my attention while studying the

chart is the timing following the bull market top of 1929. Note that following the 1929-32 crash, it took a quarter of a century or until 1954 until the Dow moved up and again surpassed its 1929 high. Neither the bull market of 1932-1937 nor the bull market of 1942-1946 was able to take the Dow above the 1929 high.

In 1949 the second super-bull market of the century began (the first, of course, being that of 1921-1929). This was the primary bull movement which finally succeeded in bettering the 1929 peak of 381.17. The hurdling of the 1929 high had as much as anything to do with bringing the crowd back to Wall Street. As long as the 1929 highs remained impenetrable,



the nation did not seem to realize that a bull market was on (despite the fact, for instance, that the 1932-1937 bull market produced a huge percentage gain in the Dow).

The next phenomenon which I note is that following the 1949 bottom, little time was consumed following each reaction before the Dow Industrials roared to a new all-time high. For example, the Dow touched a temporary peak of 293.79 in 1953. The following year the 1953 high was bettered. The next temporary peak occurred in 1956 at 521.05. This peak was approached within a point during late 1956 and again in 1957. By late 1958 the 1956 high has been surpassed.

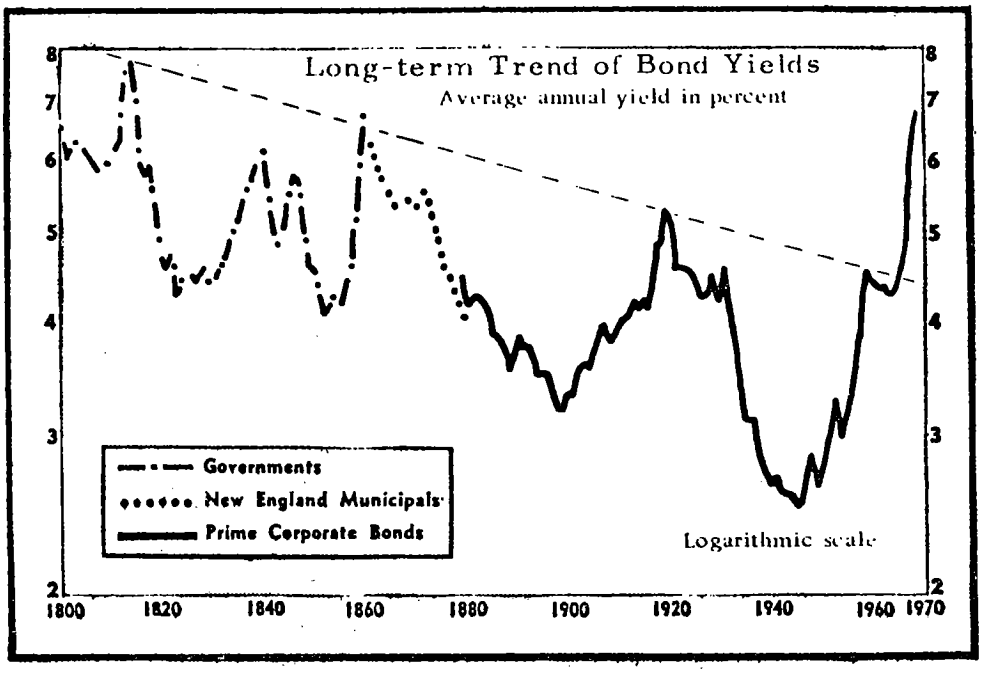
The 1959 high of 685.47 was followed by a reaction but by 1961 the 685.47 peak was hurdled. Again in 1961 the Dow touched a high of 734.91, and this was followed by the severe 1962 collapse. Nevertheless, by late 1963 the Dow had succeeded in bettering the 1961 top.

Now comes the bull market high of 995.15, recorded on February 9, 1966. This was followed by a 251 drop to the 744.32 low of late 1966, after which the Dow started up again. Despite the greatest infusion of inflation ever pumped into the American economy, the 1966 high has so far not been surpassed. Furthermore, as of this writing three years and three months have elapsed since the 1966 high, the longest period without a new high on the Dow since the bull market began in June, 1949.

I believe that the long time span since February, 1966 (without a new Dow high) is most significant. Robert Rhea frequently mentioned that the longer the elapsed period prior to a confirmation (i.e., a surpassing of preceding peaks by both Averages), the less the significance of the ultimate confirmation.

All in all, I would be somewhat surprised if today's buying could push the Dow above it's 1966 high, and I would seriously doubt that even if the Industrials could push above 995.15, the Rails would confirm. Furthermore, after three-and-one half years, I would place little significance on a final thrust by the Dow above its 1966 peak. The time lapse has been too great to make such a bettering of the 1966 high an event of any great import.

UNRELENTING PRESSURE: Last week the pressure on the banks in the form of borrowed reserves was $1,176 million, highest since records were first kept in early 1950. In spite of this, loans at New York banks were up $15 million, against a drop of $216 million in the comparable week. last year. To all appearances, it seemed that nothing would halt the upward march of business spending and the pressure for new loans.



Many leading economists were ready to throw in the sponge regarding the Government's efforts to halt inflation. The majority of experts appeared to feel that the Nixon request to repeal the 7% investment tax credit was about the last weapon in the Government's anti-inflationary arsenal.

In an article in the May 12 Weekly Bond Buyer, ("Stock Market Bullishness vs. the Inflation Powder Keg") a number of leading economists opined that nothing would halt the inflationary pressures, and that the best that could be expected would be a sort of leveling off, preparatory to resumption of the boom on a bigger scale than ever.

An interesting perspective on the situation is provided by the very long term chart of bond yields, covering the period of 1800 to date. My common sense plus my knowledge of history tells me that long-term bond yields simply will not stay at their current levels. Since 1800, in fact, every extended rise in bond yields (such as the present one) ended with a spike and rapid reversal. The reversal was brought on by panic or semi-panic conditions and a liquidation of outstanding credit.

It is immediately obvious that since the early 1800's, each peak in bond yields occurred at a lower level than the last. This series of lower peaks produced the descending trendline as shown on the chart. But the present peak in the 7% area has broken above the trendline and taken bond yields to civil war levels, at which time the credit of the nation was extremely tenuous.

I hereby take issue with all the economists who hold that the current situation represents some kind of a new norm and is only a stepping stone to a greater inflationary era in the immediate future. My instinct tells me that we are entering a period which will be characterized by a stock market smash, chaotic monetary, economic and social conditions and accompanied by credit liquidation on a massive scale.

The psychology of the times is now absolutely at a peak of unreality. Debt and credit are extended to a point which would have astounded businessmen in any other era in history. I include this little clip (page 4) from the May issue of Dunn's Review, from an article entitled "The Wild Swingers of High Finance." It illustrates the type of thinking which has allowed leading corporations to extend themselves dangerously during one of the wildest periods of American financial history.

The purpose of a primary bear market is to correct the excesses of the preceding boom. As of this writing, three years after the 1966 bull market top, none of the boom excesses have been corrected. I feel that there will be hard times ahead, as the nation experiences the ultimate smash which will serve to squeeze the water out of a boom which by some reckoning began in 1942 and by other figuring began in 1949.

LAUGH CLOWN: I couldn't help laughing as I read last week's newspapers. And maybe when everything becomes so somber and hard-to-take that it seems impossible, that's what saves Americans—their great sense of humor.

THE NEW YORK TIMES, MONDAY, APRIL 21, 1969

Youth Decency Rally Turns Into Melee

BALTIMORE, April 20 (AP)—A youth decency rally attended by 40,000 persons erupted today into wild, fist-swinging mêlées among groups of youths.

Eighty-eight persons, including seven policemen, were injured, and more than 80 were arrested. The injured included several who were stabbed.

For instance, who can read this newspaper clip about a "youth decency rally" that turned into a youth riot without smiling. It's as if the "theatre of the absurd" had taken over social mores in America.

Then I read in a full page Wall Street Journal ad that Lums Inc. restaurants is teaming up with the Rowan and Martin "Laugh-in" program to produce a new franchise, the "Laugh-in Restaurant Corp." The new restaurants, the ad states, are for the millions of Americans who are "young in heart." We are told that this type of person is ready for Laugh-in, "They swing. They go places. They eat out!" True perhaps, but I'm be darned if I see why these swinging chowhounds would accept a connection between a comedy TV program and a place to dine. Could I be missing something? Anyway, for a minimum of $34 thousand you can get a franchise and find out whether the idea has merit.

Next I read that the city of Philadelphia is actually going under financially. That if the State and the Government don't come in with fistfulls of greenbacks, Philadelphia (the city of brotherly love) will actually go bankrupt. Ten years ago I guess it would have been rather tragic, but somehow today the thought of a great American city going "to the cleaners" is simply absurd.

The final topper is avant-gard writer Norman Mailer and ex-columnist Junny Breslin running on the New York mayorality ticket. But when you think about it, why not? Nobody else has saved New York. Maybe a little madness will bring the city back to sanity. Mailer wants statehood for New York City, and he wants to bring the Dodgers back to gotham. Asked about making marijuana legal, candidate Mailer retorted, "Hell no, I wouldn't be in favor of making it legal. You're all out of your heads. Make it legal and the cigarette companies will come in and put filter tips on your pot and vitamins and menthol in your pot. No, I say keep it criminal. There are some illegal acts which should be cherished." It should be an exciting campaign.